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C O N F I D E N T I A L QUITO 000293

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TAGS: [EPET](#) [EINV](#) [ECON](#) [EC](#)  
SUBJECT: ECUADOR'S OIL CONTRACT RENEGOTIATIONS SLOWER THAN  
PORTRAYED

REF: A. QUITO 164  
[1](#)B. QUITO 226  
[1](#)C. QUITO 55  
[1](#)D. 07 QUITO 2277

Classified By: Classified by Charge Jefferson Brown. Reason: 1.4 B and D.

[1](#)1. (SBU) Summary: Despite press reports that the GOE is in the final stages of renegotiating oil contracts with international companies, U.S., Spanish, and Chinese companies tell us that negotiations continue, and that agreement on international arbitration is a problem. U.S. company City Oriente, which is hoping to sell its holdings to the GOE, says its negotiations are currently at a stalemate. End summary.

[1](#)2. (U) The media, clearly drawing on information supplied by the GOE, have reported that oil contract negotiations with Petroriental, Andes Petroleum, Repsol, Perenco, City Oriente, and Petrobras are close to conclusion, with the forthcoming signing of ten "modified production sharing contracts." The oil companies, however, have privately told us that they are not yet close to concluding their negotiations.

New Contracts with Better Windfall Income Provisions  
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[1](#)3. (C) Repsol confirmed to us that it is negotiating a new production-sharing contract, to replace its current production-sharing contract. The new production-sharing contract would be subject to the government's new 70% windfall income tax established in the new tax law (ref c): 70% of oil income over the reference price would go to the government. Repsol's current production-sharing contract is subject to an older 99% windfall income tax (reftel d). The big advantage of the new contract is that it reestablishes a new reference price at today's current high levels, while the reference price for the current contract is based on the much lower oil prices prevailing when the contract was signed. The government has agreed to extend Repsol's contract, which is set to expire in 2012, to 2020. We understand that the other oil companies are looking to establish new contracts similar to Repsol, with the exception of City Oriente, which hopes to sell its business to the GOE and leave Ecuador.

Andes Petroleum Closest, but not There Yet  
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¶4. (C) Chinese Andes Petroleum told us that they were close to completing their negotiation, and acknowledged that it is the furthest along in contract negotiations among the international companies in Ecuador. However, they stressed, certain concerns remain, among them the lack of a suitable arbitration venue.

Repsol

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¶5. (C) Murphy Oil, a U.S. company that holds a minority share in a consortium led by Spanish company Repsol, said the economics of the negotiations between the GOE and Repsol are going well, but that arbitration is the big issue. A Repsol representative said that the president of Repsol met with President Correa on March 25, and that the meeting was productive. He also said that the two sides are close to agreement on economic issues, but allowed that arbitration had not been discussed in the Correa meeting.

¶6. (C) In an earlier conversation with Repsol, its representative said the GOE's inability to agree to arbitration was a fundamental problem, and that the media's portrayal of the contracts being almost finished was an effort to better the government's negotiating position. According to Repsol, the GOE suggested a regional arbitration body it wants to establish under UNASUR as a possible venue, but given that the body has yet to be established, companies see this as a non-offer.

¶7. (C) Murphy said that the Repsol consortium has not filed for arbitration. However, Murphy, as an independent company, has filed for arbitration under the U.S.-Ecuador bilateral investment treaty. Murphy was quick to add that the

arbitration request could change depending on the outcome of the negotiations, suggesting they had filed in order to preserve their rights if necessary.

Perenco

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¶8. (C) U.S. company Burlington (now owned by Conoco Phillips), which holds shares in two blocks operated by French company Perenco, told us that Perenco's negotiations on Block 7 were moving very slowly, and that negotiation on Block 21 had only "recently begun."

Petrobras

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¶9. (C) Petrobras is widely seen as under considerable pressure, but both the company and the Brazilian embassy are offering minimal comment, even privately. As noted in reftel a, the Solicitor General recommended that Petrobras's contract be cancelled for transferring shares of its operations to a Japanese company. Petrobras asserted the transfer was approved by the prior government, but on March 24, the Solicitor General accused Petrobras of deceiving the prior government and reiterated his call for caducity. One foreign oil company told us that Petrobras is having a difficult time fighting GOE efforts to declare caducity, while another told us that contract negotiations between the GOE and Petrobras had broken down, but were restored the week of March 17.

City Oriente

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¶10. (C) U.S. City Oriente tells us that their negotiations with the GOE had stalled as of March 20. As noted in reftel b, the company is looking for the GOE to compensate it for its investments in exchange for terminating its contract. According to City Oriente, it has successively lowered its requested compensation from \$280 million to its final offer of \$93 million. The GOE negotiating team rejected City Oriente's final offer as outside of its acceptable range. According to City Oriente, the most the GOE is willing to

offer is \$51 million. City Oriente reports that it is open to additional discussions or other options, such as the services of a third-party expert. It is seeking a meeting with Petroleum Minister Chiriboga to see what additional options might be available, but is not pressing for the meeting until it believes that Chiriboga has additional guidance from President Correa.

Comment

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¶11. (C) We believe that the GOE realizes that it would be hard pressed to manage the foreign-owned oil concessions, and therefore wants to find an arrangement that will keep the companies here to invest and operate in their blocks. It appears that there is sufficient maneuvering room for most of the parties to reach an agreement on the economic terms, whereby the GOE would receive a greater share of the oil income. The hang-up is on arbitration, where the government does not appear ready to agree to an arbitration forum that is acceptable to the foreign companies. Even City Oriente, which has basically decided to leave Ecuador, says that the main reason they are looking for a buy-out rather than a new contract is that they could not accept the GOE's position on arbitration.

¶12. (C) City Oriente is the smallest of the foreign oil companies negotiating with the GOE, and it was relatively easy for the government to accept the idea that it could take over City Oriente's operation. It will be interesting to see whether the GOE or the larger oil companies will budge over arbitration, since their departure would be harder for the GOE to absorb. End comment.  
Brown